DEPARTMENT OF
Management & Budget

Office of Retirement Services

Serving more than 580,000 customers

July, 2007

Highlights

- Office of Retirement Services
  - Serves 1 out of every 18 Michigan residents
    - Public Schools, State Employees, State Police, Judges
  - Provided $4.7 billion in pension and health benefits in 2006
  - Current market value of the defined benefit plan's assets total more than $55 billion

Guiding Principle

- Good public policy to promote financial security in retirement
- Health care is a vital component of financial security in retirement
  - In 2006 the national average monthly cost for a pre-Medicare individual to purchase health care was $552.00 and $363.50 for a Medicare member
  - Average annual pension payout
    - Public Schools - $17,997
    - State - $16,727

SOURCE: Kaiser Family Foundation and Hewitt Associates December 2006

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National Health Expenditures 2005

- $2 trillion in total expenditures
- $6,700 per capita (all age groups)
- 16% of Gross Domestic Product (GDP)
- Increase of over two times the rate of inflation from 2000-2005

SOURCE: National Coalition on Health Care

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Health Care Cost Drivers

- Aging of the population
  - Additional retirees
- More health services available
  - Growing consumer demand for newest, best treatment
- Health care delivery system
  - Indirect costs associated with the uninsured

Highlights

Michigan Public School Employees' Retirement System

- Members include employees of public schools, community colleges, and seven universities*
- Statewide retirement system that provides retiree pension and health benefits

*Central Michigan, Eastern Michigan, Western Michigan, Northern Michigan, Ferris State, Lake Superior State, and Michigan Technological Universities (closed to new members on or after January 1, 1996)

Health Plan Highlights

- Michigan Public School Employees' Retirement System provides
  - Comprehensive medical and drug coverage
    - Average annual cost per retiree was $5,229 in 2006
    - 119,462 retirees are enrolled in the health care plan
    - 65% are over age 65
    - 60% female, 40% male

SOURCE: 2006 CAFR

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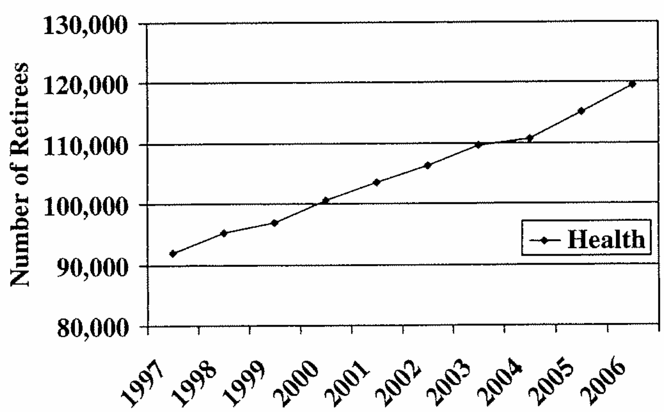
Retirees Receiving Benefits



3.5% annual increase

SOURCE: State of Michigan Comprehensive Annual Financial Reports

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Plan Basics

- Medical Plan - Preferred Provider Organization (PPO) (Non-Medicare) - Medicare Advantage (Medicare)
    - Comprehensive hospitalization
    - $250 deductible
    - 10% coinsurance
    - $500 out of pocket maximum
- Prescriptions
    - 20% co-payments with $7 min/$32 max at retail
    - $800 out of pocket maximum
    - Consumerism incentives to promote
        - Generics
        - Lowest cost setting
        - Formulary
- Dental and Vision

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Health Care Plan

- Background
    - 1975
        - The plan was enacted and fully insured; no quality and cost management
    - Mid 1980s:
        - Costs began to rise rapidly

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Health Care Plan

- Background (cont'd)
  - Early 1990s:
    - Costs continued rapid rise with Michigan in a budget crisis
    - Cost increases to continue due to more retirees and medical inflation
    - No established goals or guidelines
    - Schools had limited budgets so goals must reflect the presumed growth in their revenues
    - There would be advances in heath care

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Health Care Plan

- Approach
  - Early 1990s:
    - Plan became self-insured
    - Adopted a formal strategic planning process
      - Established goals
      - Identified options
      - Mechanism to monitor initiatives

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Health Care Plan

Established Goals

- Provide a high quality health care plan that is affordable to both the members and the schools
  - Quality Goal - "Measurably improve the quality of care enjoyed by members"
  - Cost Goal - "Limit the rate of cost growth to the compound rate of inflation (CPI) and real economic growth."

Health Care Plan

Initiatives:

- 1994
  - Implemented the Managed Prescription Drug Program
    - Generic substitution
    - Mail order pharmacy
- 1995
  - Implemented Cardiac Centers of Excellence program

Health Care Plan

Initiatives (cont'd):

- 1998
  - Nurse health information service
  - HMO pilot program
- 2000
  - Increased comprehensive deductible to $165 single, $330 family
  - Drug co-pay changed to 20% of approved amount, $4 minimum and $20 maximum for a 30 day supply at retail, $10 and $50 max for a 90-day supply

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Health Care Plan

- Since 2000, the implementation of the drug optimization program, Blue Health Connection, and cost sharing updates have resulted in savings of $150 million, while maintaining access and quality
- Most recently we implemented the Medicare Prescription Drug Plan saving $80 million in 2006 and 2007, and Medicare Advantage is projected to save an additional $40 million in 2007

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Funding Retiree Health Care

- Pay-as-you-go system
  - Employer contributions percent of payroll based on expected health care costs for the upcoming year

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Health Care Costs

- What we have done
  - Implemented plan design changes keeping the contribution rate to the school flat at 6.55% for 4 years.

Fiscal Year	Annual Costs	Contribution Rate
2001	$498 M	5.55%
2002	$558 M	6.05%
2003	$607 M	6.05%
2004	$667 M	6.05%
2005	$762 M	6.55%
2006	$694 M	6.55%
2007		6.55%
2008		6.55%

SOURCE: CAFR

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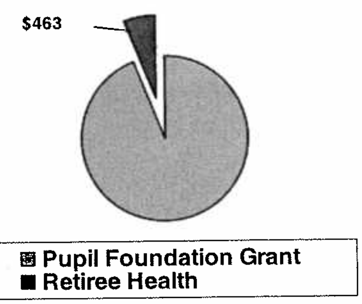
Health Care and the Foundation Grant

- The State and schools are experiencing severe budget problems
- $463 of the current $7,075 per student foundation grant goes toward retiree health care

Health Care Effects on Schools



FY 2007

The Questions

- Is health care coverage a critical component of encouraging and retaining quality personnel?
  - If so, how will the increasing cost of coverage be paid?
  - If not, how might coverage be changed?
- What effect will the Governmental Accounting Standards Board (GASB) have on health care?

GASB

- GASB requires governmental entities to report their Other Post Employment Benefits (OPEB).
  - Benefits other than pensions earned by employees over their years of service that will not be received until after their separation of employment with the government.
    - i.e. Health, Dental, Vision, Life, etc.

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GASB

- Reporting the potential long term liability in the comprehensive annual financial reports since 1999.
  - Will be officially reported in 2007 in compliance with GASB.
  - Does not create a new liability

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Public Schools - Health

- Annual costs = $694 million
- Potential Unfunded Liability = $13.2 billion
- Current Employer Contribution Rate (2006-2007) = 6.55%

Potential Unfunded Liability from September 2006 valuation and Annual Cost from 2006 CAFR

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State Employees – Health Fund

- Annual Costs = $363 million
- Potential Unfunded Liability = $7.5 billion
- Current Employer Contribution Rate (2006-2007) = 12.20%

Potential Unfunded Liability from September 2006 valuation and Annual Cost from 2006 CAFR

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What Can Be Done?

- Continued Plan Management
  - Incremental actions
    - Cost avoidance
      - Avoiding, or reducing the severity of illnesses
        - Care Management Programs
      - Shifting the costs to another party through Coordination of Benefits
        - Medicare Advantage
    - Cost reduction
      - While cost reductions may be inconvenient, they are designed so that they do not increase (and sometimes reduce) member costs
        - Drug Program Formulary
    - Cost sharing
      - Balance between what members pay and what the System pays
        - Deductibles
- Eligibility
  - Who and when
- Reduce Benefits

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What Can Be Done?

- Tackle long term funding
  - Raise revenue
- Do nothing – wait for a national solution
  - Risks include:
    - Population will continue to grow
    - Unmanaged cost increases
    - State may end up bearing the cost in another way

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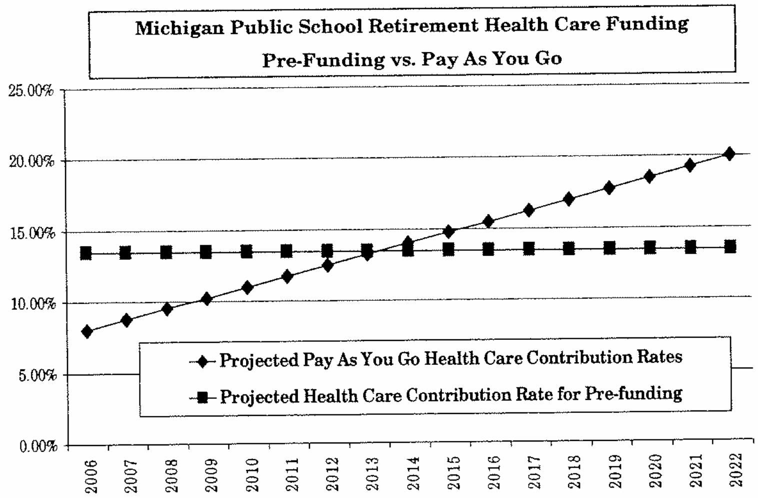
What Can Be Done?



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What Can Be Done?

- Can employers begin paying more now to stabilize health costs?
  - $13.2 billion potential unfunded liability
    - Projected 13.5% of pay for 30 years
  - Can we get an additional 7% of pay over a period of years?
    - 1% per year?
  - Should active employees contribute?
  - Years-based premium subsidy (graded premium)?

SOURCE: Annual Valuation

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Conclusions

- Pension costs have increased in the past few years but are stabilizing as the markets remain strong
- Health care costs will continue to increase
- Providing health care coverage to retirees is good public policy
  - Component of encouraging and retaining quality personnel
  - Preserve the retiree health care as a vital component of financial security in retirement
  - The need for health care exists, ultimately somebody bears the cost

Steps to Consider

- Tackle part of the plan's unfunded liability
- Be engaged at the national level
- Assess progress in two years and adjust